

**REPORT OF THE AUDITOR-GENERAL ON THE FINANCIAL STATEMENTS  
OF THE GEORGE MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009  
(5/15/1/1) LHF/mm**

**A. PURPOSE**

To consider the report of the Auditor-General (AG) on the Financial Statements of the George Municipality for the financial year ended 30 June 2009.

**B. BACKGROUND**

The financial statements of the George Municipality for the year ended 30 June 2009 have been audited by the Auditor-General in terms of section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), read with sections 4 of the Public Audit Act, 2004 (Act No.25 of 2004) and section 126(3) of the Municipal Finance Management Act (Act No.56 of 2003) (MFMA).

The audit report is attached marked Annexure "A".

**B1. ADDRESSING THE 2007/8 QUALIFICATIONS**

Since George Municipality received a qualified audit report for 2007/8 an immense effort and volumes of preparation were invested in the processes and procedures involved in compiling the financial statements for the 2008/9 financial year!

The main objective for the preparation of the 2008/09 financial statements was to be in compliance with the Standards of Generally Recognised Accounting Practices (GRAP).

The Minister of Finance has, in terms of General Notice 552 of 2007, exempted compliance with certain of the abovementioned standards and aspects or parts of these standards for the 2007/8 financial year but not for the 2008/9 financial year for the High Capacity municipalities.

All GRAP Standards therefore had to be complied with by the Municipality for the 2008/9 financial year.

This resulted in an enormous task for the financial administration as many of the standards that had to be complied with resulted in changes that had to be effected as early as with the preparation of the 2008/9 budgets.

The actual unbundling of the infrastructural assets and the immovable assets and the inclusion of the detailed assets into the Fixed Asset Register (FAR) proved to be an enormous task as nearly 3000 assets were unbundled to more than 50000!

The other qualification regarding the disclosure of Employee benefits in multiple financial years and not in a single financial year was corrected retrospectively in 2008/09.

## **C. MOTIVATION**

The implementation of all the new financial standards proved to be an extremely cumbersome and frustrating process!!

The implementation of some of the standards involved a vast amount of time and effort from management's side and most of the time not to the satisfaction of the Auditor General (AG). Any implementation of a new standard had to be undertaken not only for the 2008/09 financial year but also for the previous 2007/08 financial year as well.

The AG appointed the company Deloitte to conduct the audit for 2008/09.

The audit for 2008/09 was tremendously cumbersome for the administration mainly due to the lack of sufficient number of dedicated staff available as well as the amount of communication of audit findings that were received from the auditors on which the administration had to respond.

The following comments are rendered on the aspects mentioned in the report:

### **C1. BASIS FOR QUALIFIED OPINION**

#### **C.1.1 GOVERNMENT GRANTS, SUBSIDIES AND DEFERRED REVENUE**

##### **Paragraphs 8 to 10: GRAP 23 implementation issues:**

The municipality applied the IAS 20 financial standard for 2007/8 and since the GRAP 23 standard has not been officially approved by the National Treasury did not apply another standard.

Management responded as follows:

***IAS 20 was used as the reporting framework in 2007/8 and subsequently in 2008/9 due to the fact that no GRAP Standard existed and this was acceptable to the auditors last year. We do not want to argue the merits of GRAP 23 versus IAS 20, but the lack of clear guidance given the fact that GRAP 23 is not effective. We cannot apply a reporting framework based on frequently asked questions.***

***The ASB in their directive 5 – Determining the GRAP Reporting Framework under the heading Pronouncements of the BOARD on page 5, paragraph 10 and 11 states that entities are only permitted to adopt a Standard of GRAP as part of their reporting framework when an effective date has been***

*determined and then refers to paragraph 29 on page 6. Paragraph 29 clearly states that “an entity may select to apply the principles established in that standard” and does not say “must apply”.*

*In the responses to comments received on directive 5 (ED54) the Auditor-General under comment 29 also states that “IAS 20 Accounting for Government Grants and Disclosure of Government assistance should be included in the table in the absence of an effective date for GRAP 23 on Non-exchange revenue. We concur with the comment of the Office of the Accountant-General – “We are concerned with the scoping out of IAS 20 for public entities as well as for municipalities and their entities. We accept that there are inconsistencies between IAS 20 and GRAP 23, and agree that GRAP 23 is superior standard however an interim arrangement is required until GRAP 23 becomes effective”.*

*Due to changes made to the financial system to accommodate IAS 20 we will not be able to apply the principles of GRAP 23 at such a short notice. We will start with the preparation to implement GRAP 23.*

## **C1.2 PROPERTY, PLANT AND EQUIPMENT**

### **Paragraphs 11 to 13: GRAP 17 implementation issues:**

As predicted by various role players within local government the implementation of all the stipulations of the GRAP 17 standards will prove problematic - firstly due to the complexity of the standard and secondly due to the rigid manner in which the AG approached the audit.

This was in fact mentioned to the AG at the time of their visit to George Municipality.

It is therefore management's prerogative to disagree with the findings of the AG and management's responses are included on some of the issues raised.

*We take note of your audit finding, but do not agree with all the facts stated.*

*GM management engaged in various GRAP 17 discussions with different role players during the past 2 or more years to consider the following:*

- *The main technical requirement of GRAP 17;*
- *The practicability aspect to comply to the letter with the requirements of GRAP 17 in respect of infrastructural assets;*
- *The different options to give effect to the component approach for infrastructure assets:*
  - *Componentise GM cost based on Africon analysis*
  - *Matching Africon analysis to Samras detail*
  - *Componentise based on the detail cost records of last 5 years*
- *The level of componentisation;*

- *The historical cost as proxy for Depreciated Replacement Costs (DRC);*
- *The advantage and disadvantages of the approaches available.*

*During July 2009 GM management had to make a decision regarding PPE and Land & Building assets to proceed with the process to compile Annual Financial Statements.*

*Management decided that the global assets should be unbundled, the Aurecon assets to be brought onto the fixed asset register and that a proportional allocation of the historical cost and accumulated depreciation be performed.*

*It is correct that the above reconciliation was not performed on an individual assets basis but, it was performed per sub-asset category.*

*It is important to note that every asset that was acquired, although globally in some cases, can be traced back to invoices and a capital budget.*

*Apart from the global assets that were split into Africon assets, no assets were identified which were not originally recognised in the fixed asset register and therefore a fair value adjustment was not applicable.*

*It is noted that there are short-comings in the process followed but management took the view to:*

- *Assess what we have*
- *Implement what we have*
- *Refine as we go forward into the future*

*By using the historical cost approach, no cost, funding source information and historical data were lost. The unbundling process also had no major effect on the budgeted depreciation expenditure.*

*Additions made subsequent to the unbundling exercise were broken down to logical levels and lifespan. George Municipality is on an ongoing basis busy with refining the asset register as assets are written out and replaced with new assets.*

*This matter will receive further attention during the current financial year.*

### **C1.3 CASH AND CASH EQUIVALENTS**

#### **Paragraph 14: GRAP 2 Trade Receivables:**

Management responded as follows on the audit finding:

*We do not agree with your audit finding as the amount of R6 948 343 represents prepaid electricity transactions processed through Itron (Actaris) vending cashiers.*

*This amount is disclosed as “outstanding deposits” which is a valid reconciling item as the transactions were already processed in the general ledger as revenue – sale of electricity, but the deposit in the bank account is still outstanding as at 30 June 2009.*

This practice has been followed during the past years and will be rectified in future years.

To render a qualification on this matter seems unreasonable to management.

## **C2. QUALIFIED OPINION**

Taking the specific aspects mentioned by the Auditor-General in the report that warranted a qualified opinion into consideration, it remains the opinion of management that these technical aspects have no impact on the fact that the municipality can be regarded as a going concern and that these aspects have no influence on the financial results achieved for 2008/9.

## **C3. EMPHASIS OF MATTERS**

### **C3.1 Fruitless and wasteful expenditure:**

#### **Paragraph 16:**

Management included a disclosure in note 49 to the financial statements regarding this issue on request of the AG.

Management indicated to the AG that Council still has to resolve on this issue and that the total amount as mentioned in the report may not be regarded as fruitless and wasteful expenditure depending on the decision by Council on the way forward with this specific process.

### **C3.2 Material under spending of the budget:**

#### **Paragraph 17:**

The audit finding is noted by management and the AG was informed of the reason for the comparison with the adjustment budget figures in the section 71 reports.

### **C3.3 Events after the reporting date:**

#### **Paragraph 18: Drought relief:**

The allocation of R15 million to the Municipality by the National Treasury should only be noted.

**Paragraph 19: Suspension of Audit Committee Chairperson by Council:**

To be noted.

**C3.4 Restatement of corresponding figures:**

**Paragraph 20:**

The errors that are referred to are due to the application of different financial standards in 2007/08 which were retrospectively adjusted during 2008/09 in the financial statements.

**C3.5 Casting errors in the financial statements:**

**Paragraph 21:**

Immaterial and only to be noted.

**C4. OTHER MATTERS**

**C4.1 Paragraphs 22 to 26:**

No additional comments.

**C4.2 Key governance responsibilities**

**(a) Paragraph 27:**

Comments are only rendered on the aspects where according to the AG the implementation of certain key governance responsibilities was not sufficient:

No	Matter	Y	N
<b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.  <b>COMMENTS: The AG followed a completely different work procedure as in previous years and some of the information was not requested in the same format as previously.</b>		■

No	Matter	Y	N
<b>Quality of financial statements and related management information</b>			
2.	<p>The financial statements were not subject to any material amendments resulting from the audit.</p> <p><b>COMMENTS: This was mainly due to the interpretation by the municipality and the AG that differed.</b></p>		■
3.	<p>The annual report was submitted for consideration prior to the tabling of the auditor's report.</p> <p><b>COMMENTS: Administration is not compelled by the MFMA to submit the Annual Report before February 2010.</b></p>		■
<b>Timeliness of financial statements and management information</b>			
4.	<p>The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.</p> <p><b>COMMENTS: This aspect was reported to Council previously as required by the MFMA.</b></p>		■
<b>Availability of key officials during audit</b>			
5.	<p>Key officials were available throughout the audit process.</p> <p><b>COMMENTS: The finding is supported but only for the period up to the completion of the statements.</b></p>		■
<b>Development and compliance with risk management, effective internal control and governance practices</b>			
8.	<p>There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.</p> <p><b>COMMENTS: Finding is not supported. AG was sufficiently supplied with relevant information.</b></p>		■
10.	<p>The information systems were appropriate to facilitate the preparation of the financial statements.</p> <p><b>COMMENTS: Due to all the changes to the financial standards some aspects as detailed in the standards as well as the volume of transactions will have to be addressed in future.</b></p>		■

No	Matter	Y	N
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.  <b>COMMENTS: Finding is not supported. AG was sufficiently supplied with relevant information.</b>		■
<b>Follow-up of audit findings</b>			
13.	The prior year audit findings have been substantially addressed.  <b>COMMENTS: This was mainly due to the interpretation by the municipality and the AG that differed.</b>		■
<b>Issues relating to the reporting of performance information</b>			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.  <b>COMMENTS: Matter will be addressed.</b>		■
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.  <b>COMMENTS: Matter will be addressed.</b>		■

**(b) Paragraphs 28 to 34:**

The audit opinions expressed in these paragraphs are noted by management and will be addressed.

**C5. REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

**C5.1 FINDINGS ON PERFORMANCE INFORMATION)**

**(a) Paragraphs 40 to 43: Non-compliance with regulatory requirements**

The municipality submitted relevant responses to all this audit findings and will have to re-evaluate current plans, procedures, mechanisms, and reporting to address these issues to the satisfaction of the AG.



**(b) Paragraph 44: Performance information not received in time**

It was pointed out to the AG by management that at the time of their request the information requested was not the final information due to the corrections that still had to be incorporated in the financial statements. It was also pointed out that the performance indicators in their final format will be included into the Annual Report for 2008/9

**D CONCLUSION**

This report is definitely not to the satisfaction of management and serious attention will have to be awarded to the issues raised by the AG.

The AG mentioned the following in paragraph 33:

***The next few years will pose greater challenges for the municipality with the ongoing transition to full compliance with the Standards of GRAP and the implementation of additional, approved Standards of GRAP. In order to deal with the prevalence of material misstatements in financial statements that have to be corrected during the audit, the municipality needs to:***

- ***develop a strategy to improve financial management controls relating to compliance with accounting standards and reconciliation and maintenance of underlying accounting records, in order to produce accurate and complete financial statements***
- ***produce monthly financial accounts for review by management***
- ***subject the financial statements to a quality review before submitting them for auditing, while the internal audit unit and audit committee can assist with evaluating the adequacy of the design and implementation of controls around the preparation of the financial statements.***

With the current number of personnel assigned with the duties to compile the financial statements these objections will not be achievable.

All officials from the Directorate Financial Services and parties involved in the preparation of the financial statements and responding to all the communications of audit findings deserve a word of sincere appreciation for their unselfish commitment.

For the management the compilation of the financial statements for 2008/9 was surely a strenuous experience mainly based on the detail in which the audit was conducted and the timeframes in which the information was required.

It is however excepted that the preparation of financial statements in the municipal sphere will in future be a continuous process involving all financial and budgetary considerations during the financial year.

Section 131 of the MFMA stipulates as follows:

**“Issues raised by Auditor-General in audit reports**

- 131.** (1) A municipality must address any issues raised by the Auditor-General in an audit report. The mayor of a municipality must ensure compliance by the municipality with this subsection.
- (2) The MEC for local government in the province must—
- (a) assess all annual financial statements of municipalities in the province, the audit reports on such statements and any responses of municipalities to such audit reports, and determine whether municipalities have adequately addressed any issues raised by the Auditor-General in audit reports; and
  - (b) report to the provincial legislature any omission by a municipality to adequately address those issues within 60 days.”

Even though most of the issues raised in the AG report are of a technical nature and mainly “frame of mind” issues, controls and procedures will be implemented to address the specific issues where possible in the current financial year.

**RECOMMENDATION**

- (a) that the report of the Auditor-General, read in conjunction with the comments of the Chief Financial Officer, be noted; **[FD]**
- (b) that the controls and procedures outlined in the report be implemented to address the specific aspects; **[ALL DIRECTORATES]**
- (c) that the stipulations outlined in section 131 of the MFMA be executed. **[FD]**

## **ANNEXURE “A”**

### **REPORT OF THE AUDITOR-GENERAL TO THE WESTERN CAPE PROVINCIAL PARLIAMENT AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF THE GEORGE MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009**

#### **REPORT ON THE FINANCIAL STATEMENTS**

##### **Introduction**

1. I have audited the accompanying financial statements of the George Municipality which comprise the statement of financial position as at 30 June 2009, the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes as set out on pages xx to xx.

##### **The accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the Standards of Generally Recognised Accounting Practice (Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2008 (Act No. 2 of 2008) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

##### **The Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3)(a) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due

to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

6. Paragraph 11 *et seq.* of the Standards of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the George Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

#### **Basis for qualification**

#### **Government grants and subsidies and deferred revenue**

8. The municipality inappropriately accounted for government grants and subsidies in terms of the Statements of Generally Accepted Accounting Practice, IAS 20 (AC 134) *Accounting for Government Grants and Disclosure of Government Assistance*. The Accounting Standards Board (ASB) has determined that municipalities may no longer apply this statement and therefore the municipality had to apply certain paragraphs of Generally Accepted Municipal Accounting Practice, GAMAP 9 *Revenue* or Standards of GRAP, GRAP 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)* to the extent that a transaction or event is not adequately addressed by GAMAP 9 *Revenue* to develop an appropriate accounting policy.
9. As the municipality's accounting policy was not developed in terms of GRAP 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)*, both revenue (government grants and subsidies) and the deferred revenue liability have been misstated as the required amendment to comply with GRAP 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)* was not made to the 2008-09 financial year's transactions and balances, nor was it retrospectively applied to the 2007-08 financial year as required by GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*.

10. As a result of applying the incorrect accounting standard for government grants, the portion of government grants and subsidies transferred from deferred revenue of R7,3 million as disclosed in note 24 to the financial statements and the deferred revenue liability with a carrying value of R260,4 million as disclosed in note 15 to the financial statements was accounted for incorrectly. As a detailed listing of assets included in the opening balance and additions, which distinguished between assets that were commissioned and assets which were still under construction, was not maintained, I could not perform reasonable alternative procedures to confirm the accuracy and completeness of deferred revenue of R7,3 million or the valuation or obligation of the deferred revenue liability with a carrying value of R260,4 million.

### **Property, plant and equipment**

11. In terms of paragraph 19 of GRAP 17 *Property, Plant and Equipment*, the municipality was required to adopt the component approach when recognising property, plant and equipment. In applying componentisation for the first time during the 2008-09 financial year, the municipality obtained the current replacement cost for each asset and used this cost as a basis to apportion the total cost of each asset subcategory to the historical cost and accumulated depreciation in the fixed asset register. A reconciliation was not performed on an individual component basis between the original value in the fixed asset register before componentisation and the value after componentisation, resulting in an unexplained difference of R87,9 million. As a result, I was unable to determine the appropriate valuation of infrastructure assets with a carrying value of R715,1 million as disclosed in note 5 to the financial statements.
12. Furthermore, infrastructure assets purchased during the 2008-09 financial year to the value of R99,9 million were not fully componentised as required by GRAP 17 *Property, Plant and Equipment*. I was unable to determine the impact of this on the related depreciation and accumulated depreciation or on the corresponding figures.
13. As disclosed in note 2.2 to the financial statements, the accounting officer is of the view that it was impracticable to apply the component approach retrospectively on initial adoption of GRAP 17 *Property, Plant and Equipment*, as required by GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*. I disagree with the accounting officer that the retrospective application of GRAP17 *Property, Plant and Equipment* could not be applied.

### **Cash and cash equivalents**

14. Cash and cash equivalents as disclosed in note 12 to the financial statements include financial assets (receivables), which are not regarded as cash or cash equivalents as defined in GRAP 2 *Cash flow statements*. Had the receivables been appropriately recognised, the cash and cash equivalents would have been reduced by R6,9 million and the trade

receivables from exchange transactions would have been increased by R6,9 million.

### **Qualified opinion**

15. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the George Municipality as at 30 June 2009 and its financial performance and its cash flows for the year then ended, in accordance with the Standards of GRAP and in the manner required by the MFMA and DoRA.

### **Emphasis of matters**

I draw attention to the following matters on which I do not express a qualified opinion:

#### **Fruitless and wasteful expenditure**

16. As disclosed in note 49 to the financial statements, fruitless and wasteful expenditure to the amount of R4,2 million was incurred as a result of a council decision to terminate any further developments on the Data Integration, Sharing and Communications Systems (DISC) project, pending further investigations.

#### **Material underspending on the budget**

17. The municipality has, in total, materially underspent on the adjusted operating budget by approximately R37,1 million. Appendix E(1) to the financial statements, however, only disclosed an underspending of R0,4 million. The reason for this difference is that the budget information disclosed in appendix E(1) differs from the budget information submitted in terms of section 71 of the MFMA.

#### **Events after the reporting date**

18. As disclosed in note 51 to the financial statements, the Southern Cape is experiencing a severe drought which resulted in certain areas within the demarcated area of the Eden District Municipality, including the George Municipality, being declared a disaster zone. An amount of R15 million was awarded to the municipality by the National Treasury for drought alleviation.
19. Subsequent to the financial year-end the contract of the chairperson of the audit committee of the municipality was terminated at a special council meeting held on 9 December 2009. Reasons for the termination have been presented by the accounting officer in the form of extracts from the minutes of the confidential matters discussed at the council meeting held on 9 December 2009.

#### **Restatement of corresponding figures**

20. As disclosed in note 38 to the financial statements, the corresponding figures for 30 June 2008 have been restated as a result of errors discovered during the 2008-09 financial year in the financial statements of the George Municipality at, and for the year ending, 30 June 2008.

### **Casting errors in the financial statements**

21. The financial statements, as well as the appendices to the financial statements contain various casting, cross-casting and transfer differences. As the differences were not material, the municipality decided not to rectify these differences, as it considered the exercise to be time-consuming and that the benefit of reconciling these errors outweighed the cost to perform such an exercise.

### **Other matters**

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

### **Material inconsistencies in other information included in the annual report**

22. I have not obtained the other information included in the annual report and have not been able to identify any material inconsistencies with the financial statements.

### **Unaudited supplementary schedules**

23. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

### **Governance framework**

24. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

### **Internal control deficiencies**

25. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the qualified opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for qualified opinion	CE	RA	CA	IC	M
8 to 10	Government grants and subsidies and deferred revenue	5	2	6		1
11 to 15	Property, plant and equipment	5				1
16	Cash and cash equivalents					1

26. The control environment deals with the role that leadership must fulfil to ensure effective controls over financial reporting. Risk assessment addresses management's identification of risks to the achievement of financial reporting objectives. Control activities are policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out. Ongoing monitoring and supervision enables an assessment of the effectiveness of internal control over financial reporting. From the qualification of government grants and subsidies and deferred revenue and property, plant and equipment it is evident that leadership oversight and monitoring is not effective to address risks to the achievement of financial reporting objectives. The lack of effective monitoring also contributed to the qualification of cash and cash equivalents. In addition to ineffective leadership oversight and monitoring, the lack of identification of risks to the achievement of financial reporting and policies and procedures related to financial reporting also contributed to the qualification of government grants and subsidies and deferred revenue.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote	6



<b>Legend</b>	
effective control over financial reporting.	
The entity does not have individuals competent in financial reporting and related matters.	7
<b>RA = Risk assessment</b>	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
<b>CA = Control activities</b>	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
<b>IC = Information and communication</b>	
Pertinent information is not identified and captured in a form and	1

<b>Legend</b>	
time frame to support financial reporting.	
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
<b>M = Monitoring</b>	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self - assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

### Key governance responsibilities

27. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
<b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		■
<b>Quality of financial statements and related management information</b>			
2.	The financial statements were not subject to any material amendments resulting from the audit.		■
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		■

No.	Matter	Y	N
<b>Timeliness of financial statements and management information</b>			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.		■
<b>Availability of key officials during audit</b>			
5.	Key officials were available throughout the audit process.		■
<b>Development and compliance with risk management, effective internal control and governance practices</b>			
6.	Audit committee		
	<ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>	■	
	<ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>	■	
	<ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.</li> </ul>	■	
7.	Internal audit		
	<ul style="list-style-type: none"> <li>The municipality had an internal audit function in operation throughout the financial year.</li> </ul>	■	
	<ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>	■	
	<ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.</li> </ul>	■	
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		■
9.	There are no significant deficiencies in the design	■	

No.	Matter	Y	N
	and implementation of internal control in respect of compliance with applicable laws and regulations.		
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		■
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.		■
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	■	
<b>Follow-up of audit findings</b>			
13.	The prior year audit findings have been substantially addressed.		■
14.	SCOPA resolutions have been substantially implemented.	Not applicable	
<b>Issues relating to the reporting of performance information</b>			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		■
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		■
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the George Municipality against its mandate, predetermined objectives, outputs, indicators and targets (section 68 of the MFMA).	■	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	■	

28. With the implementation of the Standards of GRAP, the municipality experienced difficulties in producing financial statements for audit purposes that were free from errors and omissions, although not in all instances material. This situation could have led to a further qualification of the financial statements had the municipality not adjusted their financial statements during the audit, based on my findings.
29. This is indicative of a situation where:
- oversight responsibility by the accounting officer is not effectively exercised over financial reporting
  - ongoing monitoring by the finance department is not effective enough to assess the effectiveness of internal control over financial reporting
  - policies and procedures related to financial reporting, which aim to improve the quality of reconciliations and maintenance and availability of underlying records and, therefore, the accuracy and completeness of financial reporting, are not adequately established and communicated to staff in the finance department
  - management did not adequately identify risks relevant to accurate and complete financial reporting and actions were not taken to address such risks. These risks should be identified by way of a formal risk assessment process relating to the achievement of financial reporting objectives and/or by implementing a formal and regularly monitored financial management improvement plan, which includes actions to address not only the material findings arising from the prior year's external audit, but also the control and compliance deficiencies identified in that audit. The risk assessment process should inform the agendas of the audit committee and internal audit unit, which are essential elements in the review of the design and implementation of sound internal controls to achieve good governance and accountability over financial reporting.
30. Actions implemented by management to address the prior year audit findings during the 2008-09 financial year proved to be less effective than anticipated by management as property, plant and equipment remained qualified in the 2008-09 financial year.
31. As a result of various factors, which include corrections to opening balances, reconciliation of assets and the introduction of new software to prepare the financial statements, the financial statements were, contrary to section 126(1)(a) of the MFMA, only submitted on 23 September 2009.
32. During the preparation of the financial statements, key officials were not available. Significant additional audit effort was also required to obtain the

audit evidence requested and to obtain responses to findings raised during the audit process.

33. The next few years will pose greater challenges for the municipality with the ongoing transition to full compliance with the Standards of GRAP and the implementation of additional, approved Standards of GRAP. In order to deal with the prevalence of material misstatements in financial statements that have to be corrected during the audit, the municipality needs to:
  - develop a strategy to improve financial management controls relating to compliance with accounting standards and reconciliation and maintenance of underlying accounting records, in order to produce accurate and complete financial statements
  - produce monthly financial accounts for review by management
  - subject the financial statements to a quality review before submitting them for auditing, while the internal audit unit and audit committee can assist with evaluating the adequacy of the design and implementation of controls around the preparation of the financial statements.
34. The development of a performance management system that facilitates the preparation of a performance report that is accurate and complete and available for internal and external review in a timely manner, requires urgent attention from the accounting officer with the support of internal audit and the audit committee to ensure compliance with section 40 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000)(MSA).

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **Report on performance information**

35. I was engaged to review the performance information.

### **The accounting officer's responsibility for the performance information**

36. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the MSA.

### **The Auditor-General's responsibility**

37. I conducted my engagement in accordance with section 13 of the PAA read with General Notice 616 of 2008, issued in Government Gazette No. 31057 of 15 May 2008 and section 45 of the MSA.

38. In terms of the foregoing my engagement included performing procedures of a review nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

39. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

### **Findings on performance information**

#### **Non-compliance with regulatory requirements**

40. The integrated development plan did not comply with the requirements of section 26 of the MSA as:

- it did not reflect the applicable disaster management plans as required by section 26(g) of the MSA
- it did not reflect all the key performance indicators and performance targets determined by section 41 of the MSA, as required by section 26(i) of the MSA.

41. The municipality had not developed and implemented adequate mechanisms, systems and processes for the monitoring and review of, and reporting on, performance information, as required by the sections 38 to 41 of the MSA. A performance management system has been developed for implementation during the 2009-10 financial year.

42. With the exception of the financial services directorate, the key performance indicators of the municipality are not measurable, relevant, objective and precise as required by section 41 of the MSA and section 9 of the Local Government: Municipal Planning and Performance Management Regulations, 2001 (regulations), issued in *GNR.796 of 24 August 2001*.

43. Management did not submit quarterly reports to the internal audit unit for review and therefore the internal audit unit was not in a position to report to the audit committee on performance management as required by section 165(2)(b)(v) of the MFMA. Consequently the audit committee was also not in a position to fulfil the requirements of section 166(2)(a)(v) of the MFMA.

**Performance information not received in time**

44. An assessment could not be performed of the reliability of the reported performance information, as set out on pages xx to xx of the annual report, since the information was not received in time for audit purposes.

**APPRECIATION**

45. The assistance rendered by the staff of the George Municipality during the audit is sincerely appreciated.

*Auditor - General*

Cape Town

December 2009



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*